

COMMERCIAL REAL ESTATE INSIGHT & NEWS

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The Coronavirus and the Doctrine of Force Majeure – How to Anticipate the "Known Unknowns"

BY TIMOTHY P. VAN DYCK • MARCH 20, 2020

From time immemorial, buyers and sellers have strived to address the impact of what Donald Rumsfeld famously termed "known unknowns" on their contractual relationships. Last December, a pneumonia outbreak in Wuhan, China was unknown to the world. Traced to a novel strain of the coronavirus, "COVID-19" has spread to more than 75,000 people in over two dozen countries, causing 2,000 deaths. China has responded with a quarantine of unprecedented scale and proportion, which has significantly affected the movement of people and resources within the country. These travel restrictions have already had a direct impact on Chinese manufacturing, which relies on large numbers of semi-skilled labors travelling from inland provinces to factories in Wuhan and other affected areas and working in close quarters. Economists are now openly discussing the extent to which COVID-19 will "infect" the global economy in 2020.

Previously a known unknown, how well have commercial parties prepared for COVID-19? Parties can agree in advance on what should happen if one side's performance is delayed by events beyond its control by including a *force majeure* provision in their contract. Below, we consider how this consensual excuse to performance might play out where COVID-19 has hindered a party's ability to perform.

INVOKING A FORCE MAJEURE CLAUSE

"Force majeure" (from the French "superior force") is a contractual provision allocating risk if performance becomes impossible or impracticable due to an event that the parties could not have anticipated or controlled. To invoke a force majeure clause and excuse its performance, a non-performing party must establish the following:

1. The triggering event falls within the parties' definition of a "force majeure."
2. But-for the event, the party could have performed.
3. Despite the party's diligence and good faith, performance has become impossible or unduly expensive.
4. The party has provided timely notice of the force majeure event and its inability to timely perform.

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Parties are free to define a "force majeure" to suit their needs. Typically, the seller, as the party with the non-payment obligations, will want a broad force majeure provision that covers a wide range of events. The buyer will want to limit the definition to events that are truly out of the seller's control and also have the ability to terminate the contract if the force majeure continues for an extended period of time.

ENFORCING A FORCE MAJEURE CLAUSE

U.S. courts do not recognize force majeure as a *legal doctrine*. This means that courts will not read a force majeure clause into a contract that does not have one. Consequently, the scope and extent of the force majeure clause is determined by what the parties wrote down in their contract.

A typical force majeure clause might say the following:

The parties' performance under this Agreement is subject to acts of God, war, government regulation, terrorism, disaster, strikes (except those involving [a party's] employees or agents), civil disorder, curtailment of transportation facilities, or any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement.

This clause is probably not effective against COVID-19 because of the absence of explicit reference to "diseases," "epidemics," or "quarantines." The antiquated phrase "act of God" will not help the non-performing party. Acts of God are usually limited to planetary events, such as earthquakes, floods, and tornadoes.

What about the catch-all "any other emergency"? The non-performing party might argue that this includes a government-ordered quarantine in response to a disease outbreak like COVID-19. Courts tend to construe catch-all phrases in force majeure clauses narrowly, however. First, a court will often require that the event be unforeseeable at the time of contracting (a "unknown unknown"). Outbreaks of disease are foreseeable, even if their timing is unknown. Second, applying the rule that the specific language controls the more general language, courts often limit the phrase "any other emergency" to refer only to the kinds of events specifically enumerated in the force majeure provision.

CONCLUSION

Companies that rely on finished products and component parts coming out of China should anticipate some level of disruption from COVID-19. Even domestic businesses might be surprised to learn that a supplier-of-a-supplier-of-a-supplier cannot make a delivery because of the current travel restrictions. Supply chain disruptions like this should have businesses reviewing their contracts with vendors and customers to see whether their performance – or their counter-party's performance – might be excused.

A properly drafted force majeure clause allows the parties to plan for how they will resolve performance issues in the event of known but contingent events, which by their nature are difficult to plan for in advance (the "known unknowns"). As events like COVID-19 reveal themselves, parties may be inclined to add disease outbreaks and quarantines to an ever-growing definition of "force majeure."

It is equally important, however, to address the path forward if a force majeure occurs. In most circumstances instead of permanently excusing performance and ending the relationship, the parties might benefit from flexibility: for example, granting the frustrated party additional time for performance or allowing it to perform at a different rate.

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